

## Russia's Use of Sport in Regional Development Policy

By Ben Aris, Moscow

### Abstract

Russia has launched a 1 trillion ruble (\$33bn) investment programme to modernize its infrastructure. However, plagued by corruption and bedevilled by red tape and inefficiency, the Kremlin has framed much of its regional development programme in the context of hosting international sports events. The hope is that external deadlines and quality standards will add a layer of control that will ensure this investment is spent more widely and efficiently than in the past.

After nearly two decades of neglect Russia's infrastructure is in desperate need of renewal and repair. The Kremlin has aggressively and successfully bid for the right to hold several major sporting events, which it hopes will serve as a vehicle for regional development. Russia has plenty of money to invest in infrastructural development, but what it lacks—and what the sporting events provide—is some discipline in making these investments effective. In addition, Russia's successful bid to hold the 2018 World Cup will win Russia some sorely needed prestige after over a decade of Russia-bashing by the international media. As Prime Minister Vladimir Putin told journalists following the announcement of Russia's winning World Cup bid, "Russia loves football, Russia knows what football is and in our country we have everything to conduct the 2018 World Cup at a very worthy level". Highlighting the link between hosting international sports events and Russia's infrastructural development strategy, he added that "the decision corresponds with FIFA's philosophy of developing football, especially in those regions of the world where that development is needed."

Before the current economic crisis struck in 2008, Russia's growth was close to becoming constricted by infrastructural bottlenecks: Russia ranks 125 of 139 countries in terms of the quality of its roads according to the World Bank; in 2008 power supply and demand was evenly matched with blackouts occurring; only two of the country's biggest ports along Russia's vast 37,000 km of shoreline are connected to the federal road grid; most of the rolling stock on the rail network has reached the end of its useful life, or is close to being so; only 60% of landing strips are paved, while only 48% have lights; and despite the start of a new millennium, Russians still undergo the ignominy of cold showers for a month in the summer, during which time all the country's hot water is turned off for annual repairs to plumbing.

The economic contraction that followed the global meltdown in 2008 has brought some relief and bought the government more time, but as Russia's economy comes out of the other side of the financial crisis (growth

in 2011 will be between 4% and 5% according to analysts) all these problems will return—and soon.

The reason that infrastructure has been allowed to fall into disrepair since the collapse of the Soviet Union in 1991, is that the government's number one priority has been to get inflation under control. Tariffs were squeezed, cutting utilities (the so-called *energos*) off from investment capital. At the same time, part of the Finance Ministry's motivation for siphoning off most of the windfall gains from the burgeoning oil export revenues was to sterilise the petrodollars and also contain inflation. Only a small amount of the hundreds of billions of petrodollars flooding into Russia in the last decade have actually been spent.

Everything changed at the start of 2008 when inflation fell to single digits for the first time in Russia's modern history. The battle was won. The Kremlin immediately changed tack and announced a massive \$1 trillion investment programme. This compares with the \$16 trillion the US needs to spend and the \$40 trillion all developed markets need to spend, according Renaissance Asset Managers (RAM).

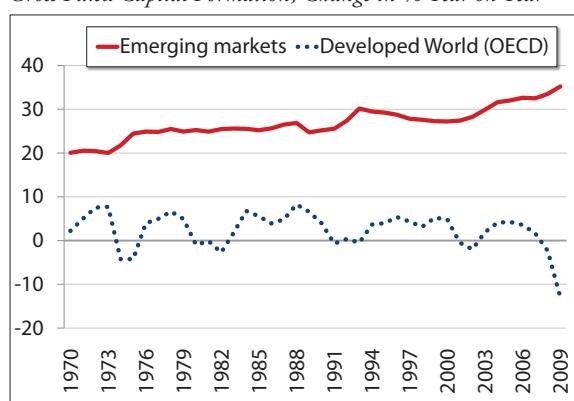
The Kremlin has already done much of the necessary groundwork. The state-owned utilities monopoly United Energy Systems (UES) has been broken up and partly privatised. The rail monopoly Russian Railways (RZD) has also been transformed into a joint stock holding company and a start had been made in reorganising it into rational pieces. A road fund has been set up and is already functioning, which will be financed by a new one ruble duty on gasoline sales. And plans to reorganise ports, airports and roads were also well in hand. Hence, in 2008 everything was more-or-less ready for investors.

### Infrastructure Investment

By launching this infrastructure drive in 2008, the Kremlin was cutting it fine, but not so fine that the lack of infrastructure was impacting growth. Prior to the 2008 crisis, the global gross fixed investment (which is largely made up of infrastructure investment) to GDP ratio was about 23%, according to Russian investment bank Troika Dialog and in fast-growing emerging mar-

kets it was closer to 30%. As a general trend, investment in infrastructure within the emerging markets has been accelerating over the last decade, as these countries “emerge”, while infrastructural investment in developed markets is falling—and falling faster now that the developed world is struggling under a massive increase in debt.

Gross Fixed Capital Formation, Change in % Year on Year



Source: Renaissance Capital

In Russia the rate of growth of fixed investment fell to 15% in 1998 and only caught up to the global average in 2007. Then, as the subprime debacle began to unwind in 2008, fixed investment started falling again, going negative in 2009. More specifically, the infrastructure investment/GDP ratio in Russia has been on the low side at around 4–5% of GDP compared with the Growth Commission’s (a World Bank-sponsored organization) estimates of a necessary level of 5–7% to sustain economic growth. By comparison, China spent 8% of GDP on infrastructure in 2007, according to Troika. In all, Troika estimates the infrastructure investment backlog in Russia is nearly three times GDP.

However, as Russia’s economy starts to recover, investment is picking up fast. Takouhi Tchertchian, who runs RAM’s Infrastructure fund, has pointed to the fact that for the next few years, investment—and specifically infrastructure investment—is expected to grow at twice the pace of the overall economy. In other words spending on infrastructure will become a major economic driver in the near term and could add as much as a couple of percentage points to the underlying economic growth, according to figures from RAM.

Russian GDP Growth 2008–2012

YOY growth	2008	2009	2010	2011F	2012F
Real GDP growth	5.6%	-7.9%	4.0%	4.9%	4.6%
Industrial Production	2.1%	-10.8%	8.2%	3.9%	5.7%
Fixed Investment	10.3%	-17.0%	6.0%	8.0%	10.0%

Source: Renaissance Capital

## Sporting Chance

The challenge Russia faces is not how to finance all this spending or even making sure that the spending is efficient. Thanks to its oil revenues, Russia can afford to waste money and spend poorly. The most important issue that Russia must address is ensuring that the money spent leads to the creation of high-quality infrastructure. Even if it costs ten-times as much to build a road in Moscow as it does in Berlin (which it does), the key is that at the end of the process the road has to be a good road. And that is where the Russian government always falls down. The plans are good, but the Kremlin has always had a problem with implementation.

The Kremlin is attempting to get around this problem by hosting major sports events. The beauty of this plan is that in addition to a major overhaul of the infrastructure in the regions that will hold these events, there is a fixed deadline by which time the work must be complete and the results must meet international quality standards in the eyes of external inspectors. Moreover, because of the prestige associated with holding these events, the Russian companies doing the work understand that the glare of the international media will be on them, and that the consequences of failing to meet these standards will be severe.

This strategy was trialed with Russia’s successful bid to host the 2014 Winter Olympics in Sochi, on the shores of the Black Sea. Tchertchian, who recently travelled to Sochi to inspect the current preparations, reports that most of the construction is well in hand. “Progress has been good and most of the major works are well underway,” says Tchertchian. “Moreover, some of the construction methods being employed are very progressive. Olympstroy [the state agency that is overseeing the work] says this will be the greenest Olympic complex ever built. Most of the stadiums are using solar panels for power. The materials are also high tech. And many of the facilities have been built in movable segments like giant Lego so that after the games are over the foundations and utilities remain, but the site can be redeveloped and turned into something else.”

Prime Minister Vladimir Putin has personally spearheaded the effort, with preparations begun even before Sochi was chosen as the host city in 2003. Most observers believe that Russia won the right to host the games because of the sheer will and power of Putin himself, who personally oversaw the presentation efforts. When Putin met with the Olympic committee panel to present Russia’s case, he was flanked by Oleg Deripaska and Vladimir Potanin, two of Russia’s richest men. After six years of planning and construction, Potanin, the controlling shareholder of Norilsk Nickel, has already invested \$1bn in developing Roza Khutor, which has

been expanded from a ski resort to a huge multifunctional complex for the 2014 Olympics. Roza Khutor was supposed to host competition for ten sets of Olympic medals: downhill, super G, giant and combined slalom. The Putin administration then instructed Potanin to prepare the complex for Olympic competition in two more disciplines—snowboarding and freestyle. Potanin will also build an Olympic village for 2,900 sportsmen, which constitutes almost half of all expected athletes; the other Olympic village, built by Oleg Deripaska in the Imeretinsky valley, is designed to accommodate 3,000. He has also bought the local airport, which is being expanded to handle international flights.

There have been some reports of corruption and delays, but Putin has personally knocked heads together and, at this point, progress on the Sochi development seems to be smooth, with more and more of Russia's business elite becoming involved.

### Football and Trains

In spite of the importance of the Sochi Winter Olympics, the real coup was Russia's successful bid to host the 2018 World Cup. Football is a popular sport in Russia, but Russia (and the Soviet Union before it) has never done particularly well in the tournament, failing to qualify several times and never getting beyond the quarter finals.

As part of the bid, the Russian government promised FIFA it would spend at least \$10bn to develop the infrastructure in 14 cities—13 in European Russia, in which 80% of the country's population live, and Yekaterinburg in the Urals. However, in practice the Kremlin is actually planning to spend at least five times that amount on related work, which will all be done within the framework of preparations for the tournament.

The infrastructural preparation and development plans for the World Cup represent a massive expansion of the Sochi model. Russia has been directly challenged by China, which hosted the last Olympics and more recently the World Expo, winning acclaim for both by spending billions on these shows; the Shanghai Expo brought in a record 72m visitors—and that is the point of these events: they are supposed to be a coming-of-age party.

In Russia, the roads, bridges, rail, airports, ports and sports facilities will all be brought up to world-class standards. RAM's Elena Kolchina argues that "this will substantially increase productivity, employment and increase economic growth. Historically, large infrastructure spending has tended to add a 1–2% non-cyclical layer to trend growth. On the back of this and high commodity prices, Russia can re-join the club of the high-growth countries in the world".

Inevitably commentators are asking: "Will Russia pull it off?" There is not a lot of past experience to judge this against. So far the only big international event that Russia has hosted is the Eurovision Song Contest a few years ago (this went very well indeed according to participants).

The new infrastructure should bring enormous material benefits to the local economies in the host cities. The US Department of Transport estimates that each dollar of highway investment in America leads to \$6.20 of GDP growth and given that Russia's roads are so far behind the multiplier, in Russia this will surely be a lot higher. But just as important, and a lot harder to forecast, is the intangible benefits that hosting these events will bring, mainly connected to having hundreds of thousands of foreigners visiting Russia for the first time.

Following the World Cup decision, Putin pointed out that the Cold War had left an enduring stamp on the world's view of Russia, and this "flies all over Europe, all over the world, buzzing in people's ears and scaring them". He added that "we must show that we are open ... People will come and see for themselves. The more contacts, the faster that stamp is destroyed." A large part of Russia's bad international image is the result of sheer ignorance about what Russia is like. In a comparable case, Germany found that it earned a huge amount of credit from hosting the World Cup in 2006, which was seen as acting to counteract much of the lingering prejudice against Germany from the Second World War. Football fans that visited Moscow in 2008, when the city hosted the European Champions League final, had, for the most part, only good things to say about the trip.

While the western press continues to paint a picture of Russia as a fascist police state populated by paupers and under a perennial blanket of snow, the reality is that the people are intelligent, well educated, hospitable in the old school style, and fun. The huge influx of visitors that any World Cup brings will do more for Russia's image than any marketing campaigns can hope to achieve. And the charm campaign has already started. The Kremlin has promised to waive visa requirements for anyone with a World Cup ticket and will also offer free internal flights to allow fans to travel around the country to get to matches (which by itself will engender a lot of good will).

Also, the practical results are already materialising. The Kremlin is currently focussing its attention upon reforming the railways, a process which is now well advanced. In addition, the World Cup decision was shortly followed by an ambitious plan to build a high-speed rail network. The first Sapsam (Russian for Peregrine falcon) high speed train began to operate between Moscow and St Petersburg in December 2009

and plans for an extended network were rolled out in January 2011. The Moscow–St. Petersburg train cuts the journey time between Russia's two main cities (and the two biggest cities in Europe) to just 3.7 hours from 8 hours, and RZD says it will spend a total of €50bn (€14m–€22m per km) on several more routes before 2018. Total investment into the Moscow–St Petersburg track will be €10bn–€15bn, with a third coming from private sources.

The next high speed route will link Moscow and Nizhny Novgorod, with several more routes due to appear this year. Speaking to reporters on 28 January, Denis Muratov, CEO of RZD's High-speed Rail Lines unit, said that 660km of new routes should be up and running by 2017, which will link the capital with the host cities of Samara, Kazan and Yekaterinburg.

#### *About the Author*

Ben Aris is the editor/publisher of Business New Europe (<http://www.bne.eu/>), an online news resource and publication covering business, economics, finance and politics in Central, Eastern and Southeast Europe and the former Soviet Union.

#### *Further Resources*

Ongoing analysis of Russia's infrastructural programme is available by signing up to BNE's free fortnightly newsletter, covering Russia and the CIS. Back issues can be found at: <http://www.bne.eu/dispatchList.php?code=Infrastructure>. To register to receive the newsletter please go to: <http://www.bne.eu/users/register.php>

## ANALYSIS

# The Olympic Games in Sochi: Infrastructural and Security Challenges

By Valery Dzutsev, Maryland

## Abstract

The 2014 Winter Olympic Games in the seaside resort city of Sochi has become a unique self-imposed burden for Russia. The massive preparative works for the Olympics have highlighted the state's incapacity to manage vast construction and infrastructure projects effectively. The proximity of the Sochi Olympics site to areas of militant activity in the North Caucasus poses security risks for the games' visitors that can hardly be ignored. In addition, the Olympic games in Sochi have revived a skeleton in Russia's closet—the Circassian genocide issue, a people that once occupied the lands around Sochi, but were partly exterminated and driven out by the Russian empire in the 19<sup>th</sup> century.

## Sochi Olympic Paradoxes

Russia is known for its cold weather, which was supposedly one of Russia's competitive advantages in the contest for the right to host the 2014 Winter Olympics. Yet, the Winter Olympics in Russia will take place in the warmest part of the country, which is referred to as the only area in Russia with a subtropical climate. The average temperatures in Sochi in January are above +5°C, even though

Analysts at VTB Capital in Moscow state that “the estimated cost of the high-speed train network suggest that World Cup spending could reach about \$85bn (\$65bn for trains plus roughly \$20bn for stadiums and related infrastructure, as estimated in December 2010 by Minister of Finance Alexey Kudrin).” Furthermore, they note that “the announced preliminary estimates of the World Cup costs exceed our initial expectations of \$50bn and support our view that the government's preferences are shifting towards higher infrastructure spending. This, coupled with the close to zero real interest rates, would help to boost investment, which we see as the key GDP growth driver in the near term.”

the nearby mountains provide slightly colder weather during wintertime. This is just one of several paradoxes about the Winter Olympic Games in Sochi in 2014.

The initial costs associated with preparing the necessary infrastructure for the Olympics in Sochi were estimated at \$12 billion. Then the number rose to \$15 billion. Now the official estimate by the Russian Ministry for Regional Development exceeds \$30 billion, with most